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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

May 19, 1994

EX PARTE

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

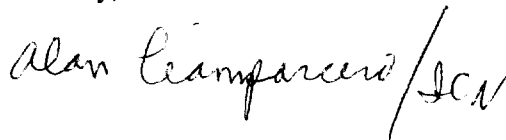
Re: *PP Docket No. 93-253, Competitive Bidding*

On behalf of Pacific Bell, on May 18, 1994, Paul Milgrom, Stanford University, responded to staff inquiries regarding the proceeding indicated above. The attached is a written response to those inquiries. Please associate this material with the above-referenced proceeding.

Two copies of this notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's Rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,



Attachment

cc: Evan Kwerel

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Message 7/19 To ekwerel@fcc.gov

May 18, 94 12:01:27 pm -0700

Subject: Narrowband rules

To: ekwerel@fcc.gov

Date: Wed, 18 May 1994 12:01:27 -0700 (PDT)

May 18, 1994

Dear Evan:

Preston McAfee called me last night to confer on the Narrowband Rules. I have not yet read the 3rd or 4th Report and Order, so I am not fully up to date. However, Preston indicated even more forcefully than you had that there is an urgency to these matters and that an outcome on narrowband that is perceived as a failure would threaten the application of the rounds of simultaneous bids design to broadband licenses. So, I thought that some immediate comment might be helpful.

First, Preston and I discussed Dan Vincent's variation of the withdrawal penalty. In general, early withdrawals do very little damage and small penalties for such withdrawals are appropriate. What threatens to be most damaging are withdrawals by bidders late in the auction, long after the competing bidders have dropped out or switched their strategies to acquire substitute licenses. For this reason, it is important to encourage a bidder that plans to withdraw to do so as early as possible, before other bidders have either committed to alternative licenses or have become inactive. The fault with the Vincent rule that caps the withdrawal penalty at an amount equal to the SMALLER of the actual loss of government revenue or the last bid increment is that it virtually eliminates any incentive for the bidder to avoid that damage by withdrawing earlier. Such a change would make it much more likely that most withdrawals will occur late in the auction, when they do the greatest potential damage. I urge the Commission to retain instead its "modified McAfee rule," imposing a penalty equal to the difference between the bid and the eventual price, plus the 3% "resale commission."

The second issue Preston and I discussed was modifications to the design that could assure the pace of the auction. Preston and I are agreed that the most damaging way to speed the auction is to speed its conclusion in the final stages. It is at the final stages that the auction does the hard work of trying to distinguish between the top few uses of the licenses and it is also then that the auction extracts the highest prices for the government, by forcing the price up to the value of the license in its second best use. If bidders believe that they can, by slowing the auction in the early stages, encourage an early closing with a more random allocation and lower prices in the final stages, then it would surely be in the interests of some bidders to do that, undermining the value of the speed-up rules.

A better solution to the pace problem is to find ways to ensure that temporizing bids are unavailable or unattractive, so that bidding will begin at a substantial fraction of bidders'

value estimates. Last fall, Bob Wilson and I considered several alternatives that were designed to do just that. We never suggested these rules to the FCC for the purely political reason that we were already been criticized for the degree of complexity of our proposed design. Still, I think we had some good ideas.

One idea was to modify the activity rule as follows: a bid on a license counts toward the activity calculation only if it is at least 50% as high as the highest bid on that license in the current round. In an auction for a single item, a cautious bidder who values the license at, say, \$1,000,000 would then have an incentive to open at a bid of close to \$500,000, in order not to be shut out of further bidding by a bid of, say, \$900,000. A more aggressive bidder might even find it worthwhile to open with a bid of close to \$1,000,000 in the hopes of shutting out some bidders who open conservatively.

In a multiple license auction with the three phase activity rule, a bidder would face a potentially large penalty if it failed to make serious bids in the early rounds and also bid on just the minimum 1/3 of its target spectrum, since deeming one of its bids not to count as activity could cost it eligibility on 3 licenses. Moreover, by bidding aggressively on low-priced licenses, bidders might reduce their competitors' eligibility to their own advantage.

Cautious bidders would protect themselves against these possibilities by bidding a significant fraction of their estimated values on more than the minimum number of licenses need to retain eligibility. That would give a quick start to the auction.

Another related idea is to have the FCC specify suggested minimum bids. Bids below the suggested minimum would not qualify as "activity." Variations of this are also possible. Bids below the suggested minimum would not qualify as activity unless the bid is the highest bid in that round, or unless it is one of the two highest bids, or unless it is within 50% of the highest bid. All these variants are ad hoc but serve to protect the FCC against making a mistake in setting the suggested minimum bid too high. I can't at the moment discern any principles to guide you in choosing among these variants.

I hope this is helpful. I will be writing to you about other issues later this week. But this seemed urgent. I will send a copy to Pac Bell so that it can be filed as an ex parte contact.

Paul Milgrom